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REPORT OF THE EXPERT MEETING ON THE RELATIONSHIPS BETWEEN SMEs AND TNCs TO ENSURE THE COMPETITIVENESS OF SMEs

Held at the Palais des Nations, Geneva,
from 27 to 29 November 2000

CONTENTS

Chapter **Page**

I. Outcome of the Expert Meeting 2

II. Chairperson's summary 5

III. Organizational matters 18

Annex

Attendance 20

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I. OUTCOME OF THE EXPERT MEETING

1. The Expert Meeting on the Relationships between SMEs and TNCs to Ensure the Competitiveness of SMEs, held from 27 to 29 November 2000 in Geneva, involved some 65 experts from developing and developed countries, as well as from countries with economies in transition. Representatives from several TNCs, entrepreneurs from small and medium-sized enterprises, and officials from SME support agencies and international bodies, such as ECE, UNIDO, EBRD and the Commonwealth Secretariat, also participated in the meeting. Nineteen experts made formal presentations during the event and more than 30 experts submitted papers to the Meeting.

2. The Expert Meeting is part of UNCTAD's analytical work and technical assistance activities aimed at both strengthening the developmental impact of foreign direct investment (FDI) and promoting SME development through linkages with TNCs. It was preceded by the Round Table on TNC–SME Linkages for Development, held during UNCTAD X in Bangkok in February 2000, and the subsequent International Workshop on Technological and Managerial Upgrading of Small and Medium-sized Enterprises through Linkages with Transnational Corporations, organized jointly by UNCTAD and Intel Malaysia in August 2000 in Penang, Malaysia.

3. Building on the findings of the Penang Workshop, the Experts continued the discussion of policies and measures to forge linkages between TNCs & SMEs. They considered the role of government, the requirements of TNCs, and the contribution of international organizations in promoting linkages. They noted the important role of government in creating an enabling business environment, including the legal and regulatory framework, as well as the physical and educational infrastructure. It is also important for government to create the right conditions for SMEs so that they can meet the requirements of TNCs. TNCs can help SMEs to cope with the challenges of globalization by facilitating access to markets, technology, skills and finance. SMEs, to enter such linkages, need stability of vision and management. International organizations can assist this process by supporting programmes that are demand-driven and institution-building. The Experts underlined that, since everyone has a role to play in this process, linkages could benefit from various types of public-private partnerships.

4. The Experts discussed how globalization has changed the nature of transnational corporations' production and outsourcing networks, thereby promoting existing and future TNC-SME linkages; and how TNCs need such linkages with SMEs in order to implement their global strategies, which depend on flexibility, total cost and speed. A number of examples were given of the positive impact that TNC-SME linkages can have on national growth and development. In these examples TNCs acted as anchor companies or agents of change, and assisted local enterprises in technological and managerial upgrading.

5. However, some experts mentioned that many SMEs miss opportunities for linkages with TNCs because they cannot meet corporate and international standards for production in terms of price, quality, delivery, health, labour and the environment. In particular, SMEs in some regions such as Africa and Latin America function in an environment which is not favourable to entrepreneurship and often do not have the support services they require to be partnership-ready. It was also recognized that SMEs must have a vision of their own evolution and be prepared to transform in line with new opportunities in order to benefit from linkage initiatives.

6. Regarding the specific role of government, the experts discussed the possibility of targeting investors who could have a positive developmental impact on the local economy; and who have a corporate vision and mission to promote such impacts. Government can also actively encourage TNCs to make such a contribution, but such TNC initiatives should be voluntary and not externally imposed.

7. Moreover, government can act as a catalyst for linkages by providing a continuously improving physical and educational infrastructure, particularly for the development of engineering and management skills, and by easing administrative burdens on TNCs and especially on SMEs. Government, working together with the private sector, can create support institutions (e.g. skill training centres) that can facilitate transfer of technology and continuously upgrade education, thereby helping SMEs achieve the capability for continuous improvement. There is a need for government to consider measures to assist SMEs to invest in themselves, particularly in appropriate technology and R&D.

A. Contribution of TNCs

8. The Experts recognized the contribution that TNCs can make to the local economy by working with small and medium-sized companies for their managerial and technological upgrading. Public-private partnerships can, *inter alia*, create support institutions for which TNCs and local business share the responsibility and leadership. TNCs have benefited enormously from deregulation, privatization, trade and investment liberalization and in return should demonstrate their corporate social responsibility.

9. The experts identified a number of best practices of TNCs for the promotion of linkages, including:

- Mentoring programmes for SMEs to coach them in total quality management and continuous improvement;
- Providing SMEs with access to TNC innovation centres and corporate training programmes;
- Making available engineers and management consultants;
- Assigning staff temporarily to SMEs;
- Having regular consultations to assess progress.

10. The experts also recognized the importance of TNCs in:

- Sharing with SMEs relevant information not related to core competencies, such as market trends and future plans;
- Allowing SMEs to support operations outside the host country; and
- Providing them with additional business opportunities through business matching, brokering of strategic alliances, trade fairs, and road shows.

11. They appreciated the encouragement given by TNCs to their SME partners to diversify their customer base so as to avoid over-dependency on one linkage partner.

B. Role of the international community

12. While many international organizations have promoted SME development, few have actually worked in the area of TNC-SME linkages. Such programmes could make SMEs more partnership-ready and could have more of an impact if there were better coordination between donors and beneficiaries. The sustainability of SME support programmes could be improved by involving all the relevant stakeholders.

13. Experts suggested that the UNCTAD secretariat should:

- Put together a checklist of principles of best practices to strengthen competitiveness by promoting linkages for interested Governments, TNCS, SMEs and support institutions;
- Continue its research on the impact of foreign direct investment on industrialization, local entrepreneurship and the development of supplier conditions generally; and
- Engage in further study and intergovernmental discussions on topics (a) upon which there was no agreement, such as the impact of economic incentives and subsidies on TNC-SME linkages, and (b) where great interest was expressed, such as financial services and successful programmes for replicating TNC-SME linkages in regions which have not yet benefited from them.

II. CHAIRPERSON'S SUMMARY

14. A representative of UNCTAD's Technology Enterprise Branch gave a brief overview of UNCTAD's recent work in the context of TNC-SME partnerships, in particular the round table on TNC-SME linkages held in Bangkok in February 2000 and the follow-up workshop held in Penang, Malaysia, in August 2000. The latter encounter, sponsored by Intel, had brought together more than 250 representatives of TNCs, SMEs and meso-level institutions to share experiences on concrete ways to foster linkages, including through public-private sector partnerships.

15. She indicated that the development impact of TNCs had not yet been comprehensively studied and that more work needed to be done to identify the profile of a development-friendly TNC, what measures encouraged some TNCs to play an active role in the development of the host country, and what explained the concentration of successful linkages in certain regions such as Asia. Examples such as Unilever's involvement in Viet Nam, Fiat's operations in India or Intel's engagement in Malaysia might guide in the development of a practical action programme.

A. Role of government and meso institutions

16. The UNCTAD resource person introduced the issue of government policies and measures to promote development-friendly linkages by briefly outlining the importance of TNC-SME linkages for the host country, SMEs and TNCs. SMEs benefited from increased access to capital, management, technology, markets and new business opportunities, while TNCs maximized their performance by drawing upon a diversified network of highly specialized SMEs, as was the case in the OECD countries. A main conclusion was that TNCs needed SMEs, given the new demands of the global economy for flexible and rapid responses to changes in demand.

17. He alluded to the sometimes-problematic relationship between TNCs and SMEs in developing countries. Some local SMEs with limited production capacities tried to compete with TNCs in the same sector rather than concentrating on complementary or niche products. TNCs could be encouraged to work with SMEs. On soft-core issues like human resources, management or marketing, TNCs had already demonstrated their willingness to assist, and in some cases they were even willing to transfer non-core technology.

18. He suggested three types of government measures to enhance TNC-SME partnerships: firstly, measures to improve the performance of SMEs. There was no lack of demand for local products or services, but SMEs lacked the capacity to produce efficiently and deliver to required quality standards. SME policies should be selective and encourage a dynamic core group to develop its competitive advantage.

19. Secondly, measures to attract foreign direct investment should go beyond creating a positive image of the location and liberalizing investment rules. He emphasized the need for government to formulate a long-term national vision to target investment and TNCs which could have a positive developmental impact.

20. Thirdly, government should develop specific linkage policies that encouraged TNCs to create opportunities for outsourcing, franchising, technology partnerships (joint ventures) and spillovers to the local business community. The resource person noted that in formulating policies to foster linkages, emphasis should be placed on voluntary measures as opposed to mandatory measures.

21. A successful public-private sector partnership to foster TNC-SME linkages in Malaysia was presented by the Executive Director of the Penang Skills Development Centre (PSDC). The Malaysian Government, the private sector and academia had joined hands to respond to the increasing shortage of skilled human resources in Penang relative to the inflows of foreign and local investment in the late 1980s. The Government had embarked upon three policy objectives: firstly, to increase collaboration with the private sector, secondly, to improve incentives for training; and thirdly to establish specialized centres. This had led to the establishment of the PSDC. The Government had demonstrated its political will by providing incentives, infrastructure and a training fund. Industry had shared ideas and provided leadership, resources and experience. Academia had provided research and training.

22. The PSDC was the first industry-led institution of its kind in Malaysia to provide training in technical, management and manufacturing skills. One of its initiatives included the Global Supplier Programme, which was aimed at creating TNC-SME links. For SMEs to be included in the programme, they needed to demonstrate their willingness and readiness to transform. They also needed to take PSDC's courses on core competencies, after which they could be selected to enter a coaching arrangement with a TNC. The coaching arrangement often included various staff exchanges. For example, SME staff was given access to TNC innovation centres and corporate training programmes, while TNC engineers, management consultants and other staff were loaned to the SMEs.

23. He emphasized that in order for a meso-level institution to operate successfully its services had to be demand-driven. Industry needed to take a leading role in the running of the institution in order to ensure the proper identification of private sector training needs. In his experience TNCs were willing to contribute resources in areas of mutual interest. An added advantage for TNCs was to be able to demonstrate that they were good corporate citizens. To enter into a viable partnership with industry, institutions had to be business-like and cost-effective, have a leading edge, maintain a high profile, and create a "win-win-win" strategic alliance for all. More importantly, although Malaysia had used local content requirements to promote linkages, such methods had since given way to policies encouraging voluntary initiatives by TNCs.

24. The Vice-Chairman of the Expert Meeting presented the linkage programme of Enterprise Ireland. The objective of the Irish Government was to expand the Irish industrial base through increases in FDI and attract foreign companies that would source locally. It also sought to improve the competitiveness of the supply base by selecting and promoting SMEs so that they could respond to TNC needs.

25. Enterprise Ireland had undertaken a detailed analysis of the demands of TNCs and the ability of potential suppliers to meet those needs. Interventions included a technical audit, training and advisory services and the facilitation of linkage interaction. Constraints in forming linkages for TNCs included their risk aversion, corporate policy, lack of local autonomy, and restrictions on the share of inputs that could be purchased locally.

26. Another example of a successful enterprise development strategy concerned Mauritius, where the Government had recognized at an early stage that the private sector was an engine for economic growth. It had adopted a clear export-oriented strategy in which the main enterprise players were SMEs. The micro enterprise sector was given the opportunity to service local market needs.

27. During the discussion of the Irish, Malaysian and Mauritius cases, the experts compared the developmental impact of foreign direct investment in local production to production for export. One expert believed that some developing countries could not afford selective investment policies. These countries needed any investment they could attract. Another expert argued that investors who produced for local markets were more inclined to forge linkages with local suppliers. The demands by TNCs on local firms to produce for export markets were much higher. However, linkages established to produce for local markets were less durable and provided less incentive to the TNC to upgrade the local supplier.

28. Another presentation focused on the Sri Lanka Export Development Board strategy to foster TNC-SME linkages. The Director-General of the Board described the strategy of the Board which targeted SMEs as an integral part of the national development strategy. The strategy was focused outward and concentrated on niche markets. Enterprise development programmes enhanced SME managerial and production skills, modernized SME technology and enabled SMEs to enter into relationships with TNCs.

29. Since 1998, SMEs had been able to import new technologies duty free under the Advanced Technology Incentive Scheme (ATIS). A five-year tax exemption was also offered to investors providing 50 or more jobs. Priority had been accorded to information technology (IT) and electronic commerce. The Board had set up an IT hub and cyber trader facilities in the capital. A number of regional electronic commerce centres had also been established. These facilities provided up-to-date market and trade data and business promotion services, including business-to-business link-ups and web advertising services to SMEs unable to invest in IT-related equipment and services. Free web advertising for a period of six months was offered to those SMEs that were judged to be export-ready or potential winners.

30. Linkage programmes existed in a number of developing countries, and did not necessarily limit themselves to TNCs. For example, the Confederation of Zimbabwe Industries had started a programme with donor funding to foster linkages with "large" enterprises, the majority of which were TNCs. The programme had been successful if measured by employment created and revenues earned. To date the programme had helped catalyze 670 linkages valued at $10 million and it had created 6,500 jobs. However, when donor funding ceased, continuation of the programme would be in doubt. The programme followed the Irish model, with buyer open houses, identification of possible suppliers, and supplier-capacity audits. If SMEs needed to strengthen certain areas, capacity building was usually done through corporate mentoring.

31. Support for linkages could take various forms, e.g. the provision of infrastructure, training and economic incentives. The amount of government funding for support measures depended on policy objectives, particularly those set for industrial and private sector development. The experts were not able to agree on the precise degree of government intervention necessary to establish linkages. Most agreed that skills development, market information and matchmaking services were basic ingredients that Governments could provide. The general feeling was that private business development service providers could do a better job in meeting SME needs than government agencies.

B. The role of the private sector

32. Experts were invited to debate three points on the role of the private sector - particularly TNCs - in promoting industrial linkages.

33. Firstly, it had been agreed that SMEs with high motivation and a vision of continuous upgrading were more capable of linking-up with TNCs and meeting global production standards as required by international value chains. Experts were invited to discuss how SMEs could be helped to become partnership-ready and what kind of internal *versus* external resources should be mobilized in that respect, taking into consideration the diverse features of different sectors and subsectors of economic activity.

34. Secondly, it was observed that the motivation of TNCs to promote sustainable linkages depended on the corporate philosophy and on the specific outsourcing strategy of the TNCs. In certain cases TNCs had played a positive role in boosting local entrepreneurship and had established long-term linkages with local suppliers, often on a purely voluntary basis. Thus, experts were asked to identify under what conditions this had happened and discuss how far Governments and international agencies should go in encouraging TNCs to assume a mentoring role towards SMEs.

35. Thirdly, it was argued that public-private partnerships could be very effective in promoting TNC-SME linkages. In some cases these had developed spontaneously and without any regulatory intervention. In others, a publicly supported environment conducive to business linkages had played a key role in the linkage process. Therefore, experts were invited to discuss the newly developed public-private sector partnership models, and especially how these could facilitate SME access to vocational training or to other meso-level support measures.

C. Corporate supplier development programmes

36. According to the purchasing director of INTEL Malaysia, the objective of Intel's Supplier Development Programme was to create a network of local suppliers by nurturing existing and potential companies, thereby demonstrating the commitment of Intel to Malaysian suppliers. This was possible due to the existence of a very wide range of procurement needs which could be met locally, among which were operating activities, transport and packaging, equipment services, construction and infrastructure, manufacturing subcontracting, tooling and fabrication.

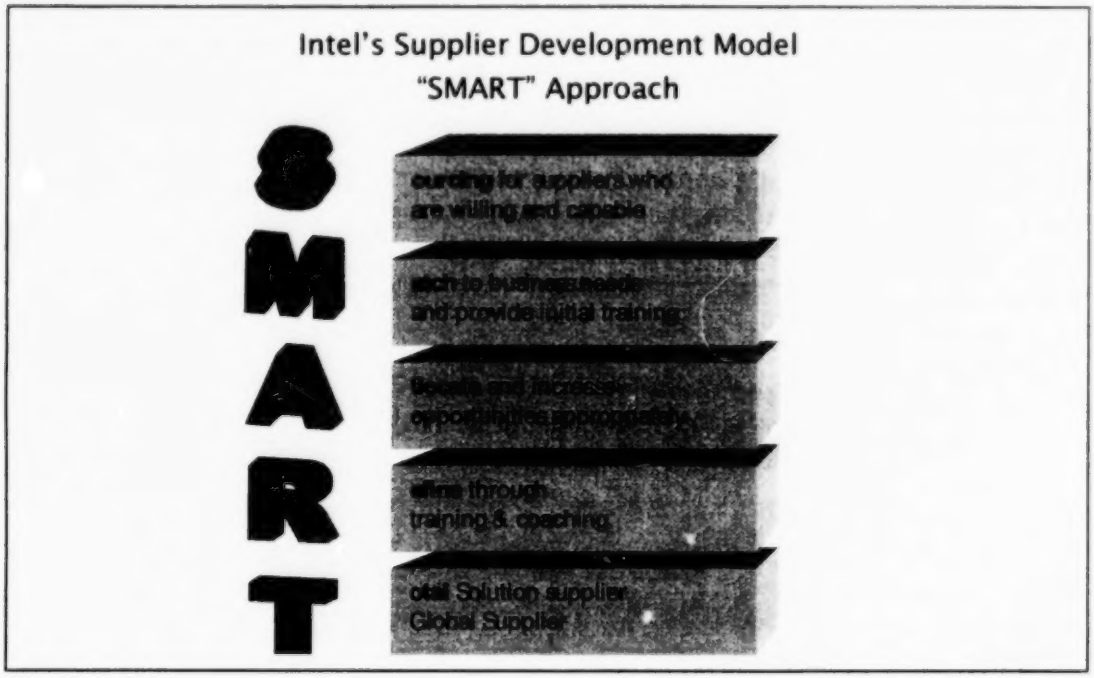
37. The ability of local suppliers to meet Intel Malaysia's requirements had reached 65 per cent due to this programme. The degree of localization of business suppliers had increased steadily since 1990 and reached one billion dollars in 1999. During the financial crisis, special cash flow arrangements had been made by Intel to avoid interruptions with local suppliers.

38. The complexity of technology transfers had also increased over the years. Intel Malaysia had decided since the beginning to share technical road maps with its suppliers in order to let them choose the right direction and position themselves correctly in the technological trajectory. In order to avoid dependence, local firms were helped to pursue strategic alliances with external suppliers. This had resulted in a successful alliance between United States and Malaysian suppliers for the fabrication of precision die molds, and between Japanese and Malaysian suppliers for the manufacture of ceramics.

39. The Director emphasized that the success of the relationships depended on selectivity and having a match between TNCs' needs and SMEs' capabilities. The different characteristics Intel looked for in a company when assessing a potential local supplier were:

- Vision of the CEO
- Willingness to learn and to transform
- Financial stability
- Quality of human resources
- Technical capability corresponding to Intel's needs
- Competitiveness potential (safety, quality, delivery, price).

40. At the beginning of the upgrading process the local company usually met only 10 per cent of these requirements, but eventually the supplier company was expected to meet all the standards. Over time it had to become competitive from a total cost perspective; it must be able to support Intel's global network and be responsive to sudden changes. It must increase the complexity of its operations. This was possible thanks to a supplier development model called SMART, where Intel selected SMEs which had the potential to meet Intel's needs, and nurtured them by providing opportunities, training and coaching.



41. Since the nurturing phase was the most critical one, in order to succeed, INTEL Malaysia directed its efforts in three complementary directions: first, it developed supplier capabilities and competencies through specialized training programmes where the PSDC was often involved (such as the Global Suppliers, the Continuous Improvement, the Safety and Health, and the Service Supplier programmes); second, it provided other business opportunities, through business matching, strategic alliances, trade fairs and road shows; third, it partnered with government and the local community through participation in activities organized by the Community Advisory Panel, the Small and Medium Industries Development Corporation and the Malaysian Industrial Development Authority.

42. Concerning Intel's primary motives in developing the "Smart" approach, the philosophy of Intel was to be an asset to the community. Company policy provided for indigenization of the managers as opposed to reliance on expatriates. In addition, the commercial benefits of local suppliers were enhanced by the availability of economic

incentives in the form of training funds and tax incentives. This made it easier to get approval from top corporate management for investments in linkage programmes.

43. The Japanese expert described industrial subcontracting in Japan as illustrated by the case of TOYOTA. After the war, the system of industrial subcontracting had played a major role in fostering the competitiveness of the entire Japanese multi-tier productive structure, allowing large firms to expand production without vast investment and to use SMEs as buffers against business fluctuations. The long-term relationship with suppliers had allowed the automotive sector to lower transaction costs and to create an effective inter-firm division of labour. In turn, this cooperative network with corporations like Toyota had enabled suppliers to perform efficiently based on quality upgrading and cost savings.

44. In the new age of more flexible production, the Japanese subcontracting system had had to become more agile. In the case of Toyota the subcontracting practice had become very selective. Small-lot production with higher value added had appeared, and suppliers had become more independent, with many horizontal relations among themselves. The corporate philosophy of Toyota was based on the following pillars: long-term commitment to SME partners, sustainability of SME suppliers, and support to the supplier associations for upgrading human resources in the whole production chain.

45. This long-term commitment had been demonstrated during the Asian financial crisis, when a number of local suppliers of Toyota in Thailand had faced severe liquidity problems. Toyota realized that without a stable network of local suppliers, its own existence was at risk, and it had thus initiated various support measures in order to keep its supply chain afloat. The actions undertaken by Toyota Thailand included price adjustments to mitigate adverse effects of the exchange rate fluctuations, advance purchases to increase turnover, compensation for excess inventory stemming from declines in orders, job transfers from local companies to local joint ventures to utilize excess capacity, and an increase in the volume of local inputs at the expense of imports.

46. A representative from Nestlé shared practical examples of TNC-SME co-operation in developing countries. He emphasized that it was Nestle's long-term strategy to be firmly rooted within the local community of the host country. There were numerous opportunities to work with local firms and suppliers, particularly in the food industry. As the bulk of inputs were localized, Nestlé recognized the benefits of learning from local producers and suppliers and of establishing long-term partnerships with them. Suppliers provided raw materials and packaging. The majority of contractors were engaged in transportation, cleaning and software services. Nestlé applied three criteria for sourcing local suppliers: quality, reliability and price. SMEs were appreciated for their ability to diversify and for their flexibility. The relationship with local SMEs was based on a system of preferred suppliership. This allowed a transfer of knowledge between suppliers and customers, constant upgrading and assistance to SMEs.

47. In order to foster viable linkages, he advised Governments and TNCs to focus only on those SMEs which had a potential for rapid growth. TNCs were not in the development business, but were ready to assist if they saw a potential win-win partnership.

48. The representative from Unilever described the preconditions for successful TNC-SME collaboration. He argued that the experience of Unilever showed how simultaneous long-term growth of the TNC, as well as of its local business partners, was possible and viable. A number of conditions had to be put in place in order to achieve this objective.

49. TNCs should act on the basis of an internally driven ethic rather than on the basis of requirements imposed from above. Their operational principles should be clear and transparent, and be based on the aspiration to become an integral part of the society and not just to exploit local resources. TNCs should demonstrate a strong degree of cultural sensitivity, and the ability to adapt to local conditions, acknowledging and respecting local diversity. Finally, TNCs should seek long-term collaboration with SMEs and a win-win situation among all the stakeholders of the partnership.

50. On their part, SMEs should start from a realistic assessment of their capabilities, demonstrate willingness to learn and have a vision for the future. They should be ready to take advantage of the support provided by the Government or other private entities. Local SMEs could thus benefit from the efforts of TNCs to establish strong market leadership when they shed non-core but essential activities. In the best case, this could result in the upgrading of the whole supply chain, from raw material suppliers to manufacturing contractors and from wholesalers to retail distributors. In addition to transfer of technologies and skills, a steady volume of orders helped SMEs invest in additional capacity or diversify, thus ensuring a certain independence from the TNC partner. The impact of Unilever's policy to make a tangible contribution to local communities and society could be seen in its operations in Viet Nam. Currently 20 per cent of raw materials and 80 per cent of packaging materials were sourced locally, and 40 per cent of production was subcontracted. In order to achieve similar results in Indonesia, UNILEVER had just created a $1 million fund for the support of first-generation SMEs.

51. The representative of BASF described the company's concept of "Verbund", or integrated production-networks, whereby all productive factors, internal and external, were integrated into a network and formed part of a highly interlinked productive chain. All BASF customers, suppliers, business partners, raw-material providers, service providers and R&D specialists in the network provided quick and efficient solutions to complex problems through strategic cooperation.

52. SMEs were an integral part of the "Verbund" concept. Cooperation with SMEs was based on mutual benefit and integration enabled them to concentrate fully on their core competencies. BASF had launched an SME innovation fund of 15 million euros in 1998 to encourage innovation through investments in technology, support of start-ups and expansion of existing companies.

53. Integration within a BASF site offered major economic advantages. Through physical integration, BASF was able to save by creating synergies in the use of infrastructure, the supply of water and energy, the management of an extended value chain, the provision of logistic and purchasing services, investments in respect of health, safety and environmental standards, and contacts with Governments.

D. Evidence of benefits derived by SMEs from linkages

54. One successful subcontractor to TNCs in Malaysia and other parts of the world described how LKT had grown from modest beginnings prior to 1978 to a recognized global supplier in the semi-conductor industry.

55. LKT had progressed from supplying limited products to one TNC to supplying several TNCs and their subsidiaries with various self-designed and self-developed products. LKT had transformed itself from a local automation support provider to a global independent solution provider. The general manager attributed LKT's evolution as a supplier of diversified products to the company's approach to linkages as well as support policies of the Malaysian Government. Tax incentives aimed at domestic firms enabled LKT to invest in R&D. Government trade missions and exhibitions played a role in the identification of and access to new markets. He highlighted TNCs as important contributors to LKT's success in their role as mentors, agents of strategic co-operation, and providers of valuable training, including the transfer of process, quality and management capabilities. LKT is now looking to build on these achievements and assure its future as a player in the industry through product diversification, developing its own brand and expanding global presence.

56. Key lessons learnt by the company from its association with TNCs included the need to:

- Always meet global standards and market expectations;
- Put in place quality systems; and
- Effectively manage business risk.

57. Another presentation by an SME on successful linkages focused on the metal industry in the Philippines which was very broad in scope but shallow in terms of the number of enterprises per product, specialization and sophistication. The director of Metalcast Corporation alluded to the tendency for SMEs to be 'generalists' as a major pitfall to be guarded against. He stressed that it was necessary for all SMEs to define their core competencies. He emphasized that government would also need, by the same token, to identify which sectors were to be supported with respect to fostering TNC-SME linkages and enterprise development.

58. He identified the problems of 'improper customer mix' (whereby an SME subcontractor was overly dependent on a single TNC as a customer) and the failure of many SMEs to invest in organizational capabilities. As an example of the first case, he cited the instance where TNCs required subcontractors to implement annual "cost downs". For many SMEs in the Philippines, the only avenue through which this requirement could be met was through reductions in labour costs. However, year-on-year wage cuts proved neither sustainable nor socially acceptable.

59. He recommended that SMEs give equal importance to the development of their organizational structure (software) and capital investments (hardware). Turning to the specific experience of Metalcast Corporation, he described the corporation as an amorphous enterprise with an organizational structure based on 'product owners' rather than on separate departments. This flexible structure facilitated a customer-focused approach and direct interaction and feedback with the customer, thus enhancing worker commitment to customer satisfaction.

60. He stated that international purchasing offices (IPOs) had played a major role in helping Metalcast establish linkages with TNCs outside the Philippines. He recommended that SMEs employ the services of IPOs in order to penetrate global supply chains and establish TNC-SME linkages. In his view, the pivotal role that IPOs played in this area warranted the organization by UNCTAD of an expert meeting focused on them.

61. In addition to utilising the services of IPOs, Metalcast Corporation also took advantage of the services offered by government trade offices, relied on referrals by its foreign customers and participated in local and international trade fairs. In his company's experience, participation in trade fairs was only worthwhile if the trade fair was an 'appropriate' one, that is if SMEs were not outclassed or overwhelmed.

62. With regard to how his company identified market opportunities, he stressed that the role played by the Government was very important. The Philippines Government had had the foresight to set up the Department of Trade which was responsible for identifying competitive domestic industries and supporting them by developing and maintaining databases on market opportunities and business inquiries and disseminating this information. His company had benefited greatly from the services of the Department of Trade, in addition to the services of the IPOs and referrals by satisfied customers, which LKT regarded as the most important method.

63. In discussing the benefits of linkages, the experts noted that SMEs ranged from survivalist to profit-making enterprises. Only the most dynamic SMEs, namely those that grew rapidly, stood a chance of becoming global players. Such dynamic SMEs could develop into international SMEs, or grow into small TNCs and become regional partners for large TNCs. Experience had shown that SMEs could also grow beyond the role of supplier and become a TNC with a regional scope. Regional agreements that allowed for free trade and investment, such as SADC and COMESA in Africa, favoured the internationalization of

firms. Benefiting from SADC and COMESA arrangements, enterprises in Mauritius had established themselves successfully in sub-Saharan Africa.

E. Sectoral and regional concentration of successful linkages

64. The experts observed that opportunities for linkages between TNCs and SMEs were not confined to knowledge-intensive sectors but also existed for non-knowledge-intensive production such as packaging, garment, footwear and toy manufacture, and the food industry. Furthermore, these linkages could often be established without major financial investments by participating SMEs. This meant that TNC-SME linkages could be achieved in regions that were technologically less advanced.

65. During the discussion, a number of experts also asked why TNCs had a preference for Asia and had so far avoided Africa as an investment location. In responding to these questions, TNC representatives highlighted a number of constraints in Africa which discouraged investors, such as low market volumes and instability, which were particularly important for TNCs for which profitability was dependent on achieving economies of scale. They also mentioned a perceived lack of entrepreneurial tradition, in contrast to Asia. This lack of entrepreneurial drive was attributed to neglect of the private sector and lack of an enabling business environment.

66. However, the point was made that there was no real reason why SMEs in Africa and other regions such as Latin America could not develop linkages with TNCs, as there were plenty of opportunities, particularly in the traditional sectors. To realize potential linkages, it was crucial that Governments in these regions develop adequate infrastructure and human capabilities in order to position themselves for opportunities that might arise. It was important for Governments and SMEs to realize that the deciding factor for TNCs was profitability. This meant that country conditions had to be competitive in order to enable domestic enterprises to engage TNC interest. The importance of education was reiterated as a necessary condition for competitiveness. Governments were encouraged to seek linkages between TNCs and universities as one way in which to address skill deficiencies.

67. The experts recognized that TNCs' and subcontracting SMEs' interests in forging linkages were different. Moreover, these differences influenced whether linkages established were based on equal partnership or dependence. This might have implications for the durability of linkages in different situations and for strategies employed to facilitate them For example, among other things, TNCs sought linkages with subcontractors in order to:

- Fill a temporary need,
- Access a product which the subcontractor manufactured, which the TNC did not know how to produce, or the subcontractor produced at a lower cost.

68. In light of the fact that TNCs were highly mobile and could easily establish themselves in other countries where conditions were more favourable, it was suggested that a

more efficient strategy was for Governments to create the conditions for SMEs to be able to meet the quality, quantity and delivery schedule requirements of TNCs rather than provide direct assistance to individual SMEs.

69. It was further stressed that SMEs should bear in mind the possibility of a rupture in their links with TNCs. Many subcontractors were dropped by TNCs in times of crisis. It was therefore important that SMEs continuously strive to develop other capabilities, diversify their products and broaden their customer base and markets in order not to become too dependent on one TNC.

70. The experts noted that some TNCs had very elaborate programmes to upgrade local suppliers, while others put more of the burden for upgrading on the SMEs themselves. However, even the "SMART" approach had benefited from public-private partnerships. Possibly the most hopeful message to SMEs was that TNCs did not expect them to meet all their requirements immediately but rather to have the potential to meet them. All TNCs that were building supply chains with a positive development impact had in common a commitment to the local community and to the host country.

71. The issue of how to overcome rivalry between competitors and foster cooperation among TNCs and between TNCs and local SMEs, as well as amongst the SMEs, while at the same maintaining a healthy degree of competition, was debated. A mixture of self-interest and community spirit compelled TNCs in Penang to work together and also to assist their local SME subcontractors. Once the TNCs came to the realization that remaining competitive depended on those around them also being competitive, they focused on achieving mutual benefits. These common endeavors were firmly rooted in the quest for continuous improvement and low total costs keeping competition alive.

72. The fact that TNCs were members of the same industrial association and were brought together by common concerns facilitated their combining forces with the local authorities and the community for their collective benefit rather than continuously asking for concessions from the local authorities. An important catalyst was the fact that the majority of the TNCs in Penang were headed by Malaysians who demonstrated a strong commitment to assisting in the development of local SMEs. This factor prompted the question of whether the same level of commitment and developmental approach could be expected from other TNCs. It also prompted the question as to whether the TNCs in Penang could be classified as developmental TNCs of the type that other developing countries should target when promoting TNC-SME linkages. It was suggested that any smart TNC was "developmental" in the long run. If an enterprise was interested in making short-term profits, it could be exploitative; however, if it wanted to remain profitable in the long run, it had to be seen as contributing to the community and exercising social responsibility.

F. Role of the international community

73. During the last informal session, presentations were made by EBRD, the Commonwealth Secretariat, UNIDO and ECE. Both EBRD and UNIDO were in the process of creating programmes fostering TNC-SME linkages, whereas the Commonwealth Secretariat and ECE had only general programmes for SME policy and support.

74. The EBRD described the particularly difficult situation in Eastern and Central Europe, where there was little experience with the private sector and where Governments were weak, which resulted in a generally hostile business environment. The SMEs which have benefited from EBRD credit and support service programmes could be classified as traders of goods and services rather than as producers who invested in productive assets and grew. This was, in part, due to restrictions whereby banks were unable to extend loans for more than one year. EBRD was searching for ways to use the initiative of TNCs. It was setting up a support system for SMEs in Kazakhstan to assist them to become suppliers to a steel plant. Whether this approach would work in Central Asia depended as always on the level of government commitment to SMEs to build a supplier base. Also the steel plant must have a long-term vision and understand that it was in its best interest to create a core of long-term suppliers rather than relying on short-term strategies to push down supplier costs. However, EBRD would not encourage Governments to provide business services, and so it was looking for alternatives, such as those that could arise from TNC-SME linkages.

75. The approach of the Commonwealth Secretariat was to make SMEs partnership-ready through a variety of services. It was shifting from serving SMEs on a one-to-one basis to institution building. It promoted competitiveness via diagnostic assessments, networking activities, and improving business development services.

76. The UNIDO representative described a pilot project with UNIDO, FIAT and various Indian authorities to upgrade local subcontractors in the automobile industry. The concept involved achieving various quality improvements in processes and products without making additional investments. The most important factor in its success was achieving a change in mindset. The upgrading programme had achieved significant results in terms of improvements in product quality, use of production space, absenteeism and sales.

III. ORGANIZATIONAL MATTERS

A. Convening of the Expert Meeting

77. At the consultations of the President of the Trade and Development Board with the Bureau, coordinators and interested delegations on 31 March 2000, member States decided to convene an Expert Meeting on the Relationships between SMEs and TNCs to Ensure the Competitiveness of SMEs. The decision was made in accordance with the UNCTAD X Plan of Action (TD/386).

B. Election of officers

(Agenda item 1)

78. At its opening meeting, the Expert Meeting elected the following officers to serve on its Bureau:

Chairperson:	Mr. Miguel Von Hoegen (Guatemala)
Vice-Chairperson-cum-Rapporteur:	Mr. Kevin Carroll (Ireland)

C. Adoption of the agenda

(Agenda item 2)

79. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in document TD/B/COM.3/EM.11/1. Accordingly, the agenda of the Meeting was as follows:

1. Election of officers
2. Adoption of the agenda and organizational work
3. The relationships between SMEs and TNCs to ensure the competitiveness of SMEs
4. Adoption of the outcome of the Expert Meeting

D. Documentation

80. For its consideration of the substantive agenda item (items 3), the Expert Meeting had before it a background paper by the UNCTAD secretariat entitled "Enhancing the competitiveness of SMEs through linkages" (TD/B/COM.3/EM.11/2).

E. Adoption of the outcome of the Meeting

(Agenda item 4)

81. At its closing meeting, on 29 November 2000, the Expert Meeting adopted the outcome of the Meeting reproduced in section I above.

Annex

ATTENDANCE *

1. Experts from the following States members of UNCTAD attended the Meeting:

Azerbaijan
Barbados
Burkina Faso
Cameroon
Chile
China
Costa Rica
Cuba
Democratic People's Republic of Korea
Denmark
Dominican Republic
Egypt
El Salvador
Ethiopia
France
Germany
Ghana
Guatemala
Hungary
India
Indonesia
Iran (Islamic Republic of)
Ireland
Italy
Japan
Kyrgyzstan
Madagascar
Malaysia
Mauritius
Mexico
Morocco
Namibia
Netherlands
Nicaragua
Peru
Philippines
Republic of Korea
Russian Federation
Rwanda
Saudi Arabia
South Africa
Spain
Sri Lanka
Swaziland
Switzerland
Tajikistan
Thailand
Togo
Tunisia
Turkey
United Kingdom of Great Britain and Northern Ireland
United Republic of Tanzania
Venezuela
Zimbabwe

* For the list of participants, see TD/B/COM.3/EM.11/INF.1.

2. The following intergovernmental organizations were represented at the Meeting:

Arab Labour Organization
Association of African Trade Promotion Organizations
Commonwealth Secretariat
European Community
League of Arab States
Organisation for Economic Co-operation and Development
Organization of the Islamic Conference

3. The following specialized agencies were represented at the Meeting:

International Maritime Organization
World Intellectual Property Organization
United Nations Industrial Development Organization

4. The Economic Commission for Europe and the United Nations Development Programme were represented at this Meeting. The International Trade Centre UNCTAD/WTO was also represented at the Meeting.

5. The following non-governmental organizations were represented at the Meeting:

General Category

World Federation of the United Nations Associations

6. The following institutions attended the Meeting:

Codeti Foundation
Economic Co-operation Organisation